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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 39

JEAN McNEIL PEPPER

vs.

SCOTT LITTON

IN THE MATTER OF DIXIE SPLINT COAL COMPANY, BANKRUPT

REPLY BRIEF FOR PETITIONER

GEO. M. WARREN,
A. K. MORISON,
M. M. HEUSER,
R. TURNER MORISON,
Counsel for Petitioner.

MAY IT PLEASE THE COURT:

Respondent, in his brief, makes the contention that the question for decision in this case is entirely different from the questions on which the Court granted a writ of certiorari, and challenges the accuracy of petitioner's statement of the facts of the case. Hence this reply brief.

THE FACTS

Counsel for respondent asserts that petitioner's statement of the case "contains so many incorrect, incomplete and misleading statements, * * * that it is necessary to restate the case * * * ." Then follows a purported restatement of part of the facts of the case, but not a single instance is pointed out wherein petitioner's statement of facts is not supported by the record.

Petitioner welcomes this invitation to a closer scrutiny of the record and the facts of the case.

The restatement which respondent found it "necessary" to make is for the most part an argumentative presentation of parts of the facts, or misleading statements of isolated events. In some instances actual misstatements occur.

As characteristic of this method of attempting to avoid the force and implications of the established facts of the case, we call the Court's attention to the following instances:

1. On page ... of respondent's brief it is asserted, or rather argued:

> "It also appears from the Pepper petition asking the Bankruptcy Court to direct the Trustee to intervene in the State Court for a decision as to the validity of the Litton execution that Pepper knew on May 25 (R. 272), that the Litton execution had been levied upon the property, and that *Pepper thus had twenty days within which to prepare the bill and present the prayer for injunction to any Judge in the State of Virginia.*"

The record does *not* show that Pepper had twenty days within which to prepare a bill and present the prayer for an injunction to restrain the *sale* under an execution from Litton's void judgment. The sale was first advertised on June 2 and was held on June 14 (R. 216, 217). Pepper's petition in the bankruptcy matter, referred to by respondent, shows that on May 25, 1934, she first learned that an execution on Litton's void judgment had been *levied*. It would have been impossible at that time for her to have had knowledge of a sale under the levy for the simple reason that a sale had not then been advertised. There is nothing in the record to show that Pepper had any knowledge of the advertised sale until June 13, 1934, the day before the sale. (R. 210). Her attorneys naturally undertook to commence suit in the court having general jurisdiction in the county where the sale was to be held.

2. On page ... of respondent's brief it is asserted that Pepper's suit in Russell County against Litton was dismissed on her motion on February 15, 1935, "which was before the trial in the independent proceedings (by the trustee against Litton) which was had on February 21, 1935." The intended inference evidently is that Pepper abandoned her suit not because of the pendency of the trustee's action, but for some other reason. The record shows that the trustee's action was commenced by the filing of a motion on January 10, 1935, returnable February 4, 1935 (R. 178 and at 180). On February 15, 1935, the day on which Pepper dismissed her suit, a demurrer was filed by Litton to the trustee's motion, which was overruled by the court (R. 190, 351). Litton thereupon filed a plea to the trustee's motion (R. 191). Evidence on the plea was not heard until February 21. But, at the time Pepper dismissed her suit against Litton, the court, by overruling Litton's demurrer in the trustee's suit, had held Litton's judgment to be void on its face.

3. On page .... of the respondent's brief it is stated that on November 1, 1934, an agreed order was entered in the interpleader suit in Russell County directing that "the $961.50, the balance of the proceeds of the sale under the Litton judgment and execution, be paid to the trustee in bankruptcy." It was, of course, lawful and proper that the trustee in bankruptcy have custody of this fund. Respondent evidently intends the inference to be drawn from this statement that Pepper, by agreeing to such an order at this time, "recognized" the validity of the Litton judgment, execution, levy and sale. However, he fails to mention the fact that the order of November 1, 1934, was set aside ten days later by the Circuit Court of Russell County (R. 257), and that the trustee received the fund in question from the clerk of the state court more than two years later, in February, 1937, and not by virtue of any "agreed order" (R. 36).

4. On page .... of respondent's brief it is asserted that the referee did not overrule Litton's plea of estoppel, "but on the contrary referred the question to the Circuit Court of Russell County for decision." No reference is made to the record to support this assertion. The referee's order of December 18, 1934, (R. 188-190, considered together with Litton's objections to the entry of the order (R. 126-128), shows beyond question that the evidence on which the alleged estoppel was based was considered by the referee. Litton's contention before the referee, as set out in his formal objections, was that his judgment could not be successfully challenged "*in any sort of proceeding*" because of the alleged estoppel, and that, therefore, the referee should then and there "declare Scott Litton's lien valid and allow it as a preferred claim." (R. 28). The referee's order, which was entered ten days after the filing of Litton's objections raising the question of estoppel, recites that

> "at that time the referee heard argument of counsel * * * and took time to consider the matter as to whether or not an order should be entered granting the prayer of the petition." (R. 189).

By authorizing the commencement of a new and independent proceeding by the trustee to test the *validity* of the Litton judgment, we assert that as a plain matter of fact the referee necessarily overruled Litton's objections to the entry of such an order. The record shows that Litton's chief objection to the entry of the order was

> "that on account of certain waivers of rights and estoppel, of which evidence has been presented to the Referee, Litton's lien can not be successfully challenged in any sort of proceeding."

5. On page of respondent's brief is this assertion:

> "Mr. S. Bruce Jones, counsel for Pepper, appeared for her in the Virginia litigation and actively participated in the trial (R. 319)".

This is a misleading, if not utterly false statement. Mr. Jones, counsel for Pepper, did appear at one day of the hearing and propounded one question to Mr. I. M. Quillen, attorney for Litton, who was at that time testifying. The record shows that counsel for both Pepper and Litton objected to this procedure and that Mr. Jones was not permitted to demand an answer to his question. (R. 320). No counsel for Pepper "actively participated" in the conduct of the suit brought by the trustee.

Respondent's statements on page of his brief with reference to the litigation between Litton and Pepper in the Corporation Court of Bristol, Virginia, during the pendency of the bankruptcy matter of Dixie Splint Coal Company are, to say the least, totally irrevelant to any issue now before this Court. If all the facts concerning

the litigation in the Bristol Court were in the record in this case, they might furnish an interesting sidelight on the present controversy. However, they are not shown in this record, and references (unsupported by the record) to isolated occurrences can be only misleading, or confusing.

It is submitted that respondent's purported restatement of the petitioner's statement of the case is utterly unreliable, and that case, as set forth in her brief, is fully supported by the record and is an accurate and complete statement of the pertinent facts of the case.

THE QUESTION FOR DECISION

In the opening statement of his brief respondent makes the amazing contention that the "question for decision is what is the estate of the bankrupt? and not whether the Litton judgment 'shall be allowed for payment from the estate of Dixie Splint Coal Company, bankrupt', as stated in the brief for appellant."

This is the result of either a total misunderstanding of the case and of bankruptcy law in general, or a belated realization on the part of respondent's counsel that his position with reference to the real question before the Court is unsound and untenable.

That there may be no doubt that the question for decision is the allowability of respondent Litton's claim in bankruptcy, we invite the Court's attention to the record.

Litton filed his formal proof of claim in the bankruptcy matter of Dixie Splint Coal Company on September 26, 1934 (R. 4, 5). The claim is based upon a purported judgment, and the supposed lien of a writ of *fieri facias* issued therefrom on March 19, 1934. Such lien is claimed upon "$961.70 of the proceeds of which said sale is now in the hands of E. F. Hargis, Clerk of the Circuit Court of Russell County, Virginia"; also "upon the sum of $868.37 on deposit in Dominion National Bank in Bristol, Vir-

ginia, to the credit of Dixie Splint Coal Company"; and "upon the sum of $5,718.19, due to the said Dixie Splint Coal Company, Incorporated, by Morris S. Hawkins and L. H. Windholz, Receiver for Norfolk Southern Railway Company." Such lien claim is also made "against any and all other sums due the Dixie Splint Coal Company, Incorporated, to which said Dixie Splint Coal Company, Incorporated, became entitled on or before the 4th day of June, 1934, the return day of said writ."

The proof states Litton's claim to be that "he is entitled to receive payment of said sums mentioned *as a prior or preferred claim against the bankrupt's estate*, and that as to the residue remaining after the application of said sums to his debt he is entitled *to share in the remaining assets of the estate as a common creditor.*"

All of the funds referred to in Litton's claim came into the trustee's hands in due course. There was never any controversy as to the right and duty of the bankruptcy court to administer said funds as assets of the bankrupt's estate. (R. 36; 309, 310, 311; 315). There is now on deposit to the trustee the sum of $6,192.20 which is the total of said sums less labor liens, costs, expenses and fees previously paid (R. 117).

Pepper filed formal exceptions to the allowance of Litton's claim in bankruptcy (R. 6).

By order entered February 22, 1937, the referee allowed Litton's claim (R. 38-42). Pepper petitioned for review (R. 43-45), and the District Court reversed the referee and remanded the proceedings (R. 52, 53). After further hearing, the referee again allowed Litton's claim (R. 107-116). Pepper again petitioned for review (R. 117-120). On June 23, 1938, the District Court entered an order disallowing Litton's claim either as a secured or unsecured claim (R. 120, 121).

Litton appealed to the Circuit Court of Appeals (R. 133), which court reversed the District Court and entered

an order having the effect of allowing Litton's claim (R. 413). On the petition of Pepper this Court granted certiorari (R. 460).

If the judgment of the Circuit Court of Appeals is affirmed, Litton's claim will be allowed and the case terminated. If this court reverses the Circuit Court of Appeals, as petitioner seeks, it will be to affirm the judgment of the District Court disallowing Litton's claim. Any other questions that may be decided will be, of necessity, subsidiary to the main question.

The fact that Litton's proof is upon an alleged lien created more than four months before bankruptcy does not, of course, affect the nature of the question, or the jurisdiction of the bankruptcy court to pass upon the validity of the claim.

LITTON'S FRAUD

The question for decision is whether respondent's claim in bankruptcy shall be allowed or disallowed. Respondent's conduct in connection with the origin of the claim and the bankruptcy of Dixie Splint Coal Company makes the case primarily a fraud case. This view of the case found expression in the second opinion of the District Court, as follows:

> "The evidence taken in this case and the disclosures made thereby since its previous consideration by the Court serve only to give additional weight to the belief previously expressed that the Litton claim and every step taken in connection with it were parts of a planned and fraudulent scheme to prevent the collection of their debts by honest creditors. The claim had a fictitious basis in the first place and was never asserted until there seemed a prospect that Mrs. Pepper would obtain a judgment on a debt justly due her. The confessed judgment was void and the sale under it obviously little more than a gesture whereby Litton was enabled to buy in the entire tangible property of

> the corporation at a nominal sum and transfer it to another of his one man corporations, thereby enabling him to continue in business after having prevented payment of his honest debts. If courts of equity, with full knowledge of such a state of facts as are here disclosed are powerless to interfere, then they are grossly misnamed and the law becomes the shield of fraud rather than a weapon against it." (R. 131).

Respondent seeks now to escape the legal consequences of his proven fraud by the argument that Pepper did not charge him with fraud frequently enough, or that the charges were not properly made, and that, therefore, the charges of fraud should not be argued.

Respondent first contends that no averment or charge of fraud was made before the referee. He then cites cases holding that it is incumbent upon one relying on fraud to assert it, including *Fogg* v. *Blair*, 139 U. S. 118; wherein this court held that it was incumbent upon one charging fraud

> "* * * to state the essential, ultimate facts upon which his cause of action rested; and not content himself with charging, generally, that what was done was 'colorable', a 'fraud', a 'breach of trust', and a 'scheme'," etc.

We accept this principle as a sound and applicable one. On December 18, 1934, Pepper excepted to the allowance of Litton's claim on the stated grounds that the validity of the purported judgment on which it was based was being litigated by the trustee, and that "the same does not constitute a common claim, since the amount claimed under said judgment was never due or owing to the said Scott Litton." (R. 6).

The word "fraud" was not used, but the ultimate, essential fact which made the claim dishonest and fraudulent was alleged in language too plain to be misunderstood.

In every proceeding in the state courts to which she

and Litton have been parties Pepper has charged Litton with fraudulent conduct. This the respondent admits, but contends that the charges were "abandoned" or Litton "vindicated". This contention cannot be supported by the record.

The suit commenced by Pepper against Litton in the Circuit Court of Russell County, Virginia, on June 13, 1934, attacking the validity and bona fides of the confessed judgment in favor of Litton and against Dixie Splint Coal Company, was not dismissed until after the bankruptcy of the judgment-defendant. Litton opposed further prosecution of the suit on this ground (R. 230). The trustee had attacked the judgment by independent suit, and Pepper had filed exceptions in bankruptcy to the allowance of Litton's claim before Pepper's suit against Litton was dismissed. This was hardly an "abandonment" of the charges of fraud.

Respondent next makes the absurd contention that the outcome of the original suit for accounting by Pepper against Litton and others in the Corporation Court of Bristol (R. 103-105) "completely vindicated Litton of all charges of fraud". Litton and his associates had denied any liability.

The Supreme Court of Appeals of Virginia (*Pepper* vs. *Dixie Splint Coal Company*, 165 Va., 179 at 191) held that Litton and his associates *were* liable and that to permit them "to escape liability for the performance of the covenants in the lease would be a fraud."

The case was remanded to the trial court for an accounting and the jury found that Litton was liable to Pepper for the sum of $4,282.94. Respondent's theory seems to be that because Litton was found to be liable for a smaller sum than the one Pepper contended for, that, therefore he was vindicated! The mere assertion of such a contention suggests the answer.

The record in this case reveals a series of planned events and transactions, each dove-tailed into the next,

which constitute a scheme or plan to defraud a bona fide creditor. Respondent seeks to explain away a few suspicious circumstances and fraudulent acts in the series of events. We will refer to a few of these attempts.

An effort is made to disprove Pepper's charge that Litton *falsely* represented to the Corporation Court of Bristol that his corporation (Dixie Splint Coal Company, now the bankrupt) intended to appeal from that court's judgment for $9,000.00 against it. The record shows that such representation was made, execution suspended for ninety days, and amount of suspending bond fixed (R. 215). It is admitted that no such appeal was ever sought. If the representation was not false, then the word "false" has lost its common meaning.

The fact that Pepper later appealed from other phases of the judgment in favor of other parties to the suit can in no way minimize the falsity of the representation made on behalf of Dixie Splint Coal Company. The motion made by Litton to dismiss Pepper's appeal (which respondent undertakes to insert in the record by way of an appendix to his brief) was answered by the Supreme Court of Appeals of Virginia as follows:

> "Motion was made to dismiss the appeal. We have examined the matters set out in the motion and fully considered the contentions of the appellee and the grounds of the motion. There is no merit in this motion and we accordingly overrule the same." *Pepper v. Dixie Splint Coal Co.*, 165 Va. 179, at p. 184.

An attempt is also made to explain the eighty days delay in filing the voluntary petition in bankruptcy for Dixie Splint Coal Company. Respondent now takes the position that there was no connection between the resolution of the board of directors of the corporation passed on June 16, 1934, and the filing of the voluntary petition on September 4, 1934. It is said that the resolution did not "contemplate" bankruptcy. Respondent has overlooked

the fact that the petition for adjudication sworn to by Litton as president recites that it is filed pursuant to the resolution passed on June 16, 1934 (R. 1).

The most transparent excuse offered for any of Litton's maneuvers is the one concerning the release by Dixie Splint Coal Company of its coal lease from Clinchfield Coal Corporation, and the immediate lease of the same coal property to Litton's newest one man corporation, Dixie Beaver Coal Corporation. Respondent's explanation is that the release was necessary

> "* * * because Clinchfield Coal Corporation, by A. K. Morison, et al, had given notice of the cancellation of the lease on June 2, because of default thereunder. A. K. Morison was, and is, general counsel for Clinchfield Coal Corporation, and chief counsel for Pepper in this litigation."

This effort to justify one of the steps in Litton's fraudulent scheme by intimating that opposing counsel knew of the fraudulent aspect of the transaction and acquiesced in it is absurd.

Here is what the record shows about the transaction:

Dixie Splint Coal Company was in arrears with its rents and royalties due to Clinchfield Coal Corporation. Under the terms of the lease agreement notice was given on June 2, 1934, "that at the expiration of thirty days from this date said lessor intends to cancel and annul said lease agreement" (page 125a of transcript of proceedings before referee—part of the record).

The amount of the arrearage was $2,153.00, which was secured by lien upon the property of Dixie Splint Coal Company, which the sheriff sold under the execution from Litton's judgment on June 14. Litton bid more than enough to pay off the Clinchfield lien, and every party in interest admitted the priority of the lien of Clinchfield Coal Corporation.

Litton's corporation did not wait for the notice of cancellation to take effect on July 2. A special meeting of stockholders was called for June 16, and on that date the release was authorized and executed (Tr. pages 125, 125b).

On June 22, 1934, ten days before the notice of cancellation would have taken effect, Litton's newly formed Dixie Beaver Coal Company acquired a lease of the same property. (R. 105, 106).

The assumption that Mr. Morison because he was counsel for the Clinchfield Coal Corporation at this time thus had full knowledge of the fraudulent aspect of Litton's conduct, and that such knowledge was imputed to another client is unwarranted in fact and unjustified in law. Neither the full implication of Litton's acts, nor all the facts composing his scheme were fully known at this time.

The significance and moral aspect of the Litton acquisition of the property of Dixie Splint Coal Company for $3,200.00, and the immediate transfer of the same property to his newest corporation for stock valued at $20,135.36, is not altered in any degree by the fact that the acquisition of the property by the new company "was a matter of public record * * * in the office of the State Corporation Commission". Of course, Mrs. Pepper had no actual knowledge of this transaction.

It is true that counsel for Pepper have not been able to anticipate each step Litton would take and be ready to thwart it with an injunction. Neither have they maintained constant search of the records of all the courts and commissions in Virginia to see what Litton would next do.

RES JUDICATA

We believe that it is perfectly clear that the question before this Court is a "proceeding in bankruptcy." It is also clear that the courts of bankruptcy have exclusive jurisdiction over proceedings in bankruptcy.

Upon principles too well known to require citation of authorities for their support, it follows that the judgment of no other court can be accorded a binding and conclusive effect in this court on the question now before it.

Respondent tacitly admits that this is true and seeks to escape the consequences flowing from the situation by contending that the question before this court was two or three different things.

First the argument is made that the question before this court and the one before the Circuit Court of Russell County, Virginia, were proceedings under Section 67f of the Bankruptcy Act. It is also contended in Respondent's brief that the action in the state court and the proceeding before his court are under Section 70e of the Bankruptcy Act. We submit that both of these contentions are utterly unsound.

The various cases cited by respondent, which deal with situations arising from suits brought under Section 67f and 70e of the Bankruptcy Act, no doubt hold what the respondent contends. Our point is that they can have no possible bearing on the present case.

It is submitted that for the reasons assigned in petitioner's brief the judgment of the Circuit Court of Appeals for the Fourth Circuit is erroneous and should be reversed.

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